SECTION 24000 PROGRAM AREA BUSINESS EXPENSE DEDUCTION

References (Repealed Sections) 17265(a); 24356.3(a)

Program Area designations expired as of January 1, 1997. Prior to this date, taxpayers had to be certified by the California Trade and Commerce Agency or TCA in order to be eligible to utilize the Program Area tax incentives. TCA could certify a taxpayer to take the hiring credit only or all five Program Area incentives. The type of certification is determined from the certification letter.

Certification was generally valid for three years. After three years, the taxpayer would have to be re-certified. De-certification could occur if a company failed to meet the requirements.

A taxpayer certified by TCA to claim all five Program Area tax incentives, and operating in a Program Area, could, for each income or taxable year, elect to treat 40% of the eligible cost of qualified property as a business expense rather than a capital expense.

The deduction was allowed for the income or taxable year in which the property was placed in service.

NOTE: For income and taxable years beginning on or after January 1, 1997, Program Areas were converted to Enterprise Zones (EZs) and are entitled to the benefits available to EZs. The following Program Area discussion relates to income and taxable years beginning prior to January 1, 1997.

24100 Geographic Boundaries and Designation Dates

For a listing of Program Area cities, see "Program Area Locations and Designation Dates " EDAM 1360. To verify an address, refer to EDAM 1300.

24200 Qualified Taxpayer

References (Repealed Sections) 17265(d)(4); 17265(e); 24356.3(d)

EDAM 24210 Pass-Through Entities
EDAM 24220 Estates and Trusts

For purposes of the Program Area business expense deduction, a *qualified taxpayer* is a person or entity (other than an estate or trust) that conducts a qualified trade or business within a Program Area.

24210 Pass-Through Entities

The determination of whether a taxpayer is a qualified taxpayer is made at the entity level. The term "pass-through entity" means any partnership or S corporation. The business expense deduction is allowed to the pass-through entity and passed through to the partners or shareholders.

24220 Estates and Trusts
References (Repealed Section) 17265(d)(4)

Estates and trusts are not allowed to take the business expense deduction.

24300 Qualified Property

References (Repealed Sections) 17265(a); 17265(d); 24356(a); 24356.3(c)

EDAM 24310 Leased Property
EDAM 24320 Property Not Qualified

Qualified property is property acquired by the taxpayer that is used exclusively within a Program Area and is defined as:

Machinery and machinery parts used for:

- Fabricating, processing, assembling, and manufacturing;
- The production of renewable energy resources.
- Air or water pollution control mechanisms;
- Property used as an integral part of a qualified business within a Program Area.

Qualified property must be purchased and placed in service *before* the date the Program Area designation expires, is no longer binding, or becomes inoperative.

24310 Leased Property

Taxpayers who acquire property by lease arrangement may be able to take the business expense deduction. The structure of the leasing arrangement itself is critical. Lease arrangements structured using a financial (conditional sales) contract generally will qualify the taxpayer to take the business expense deduction. For reference sources to determine if a lease qualifies as a purchase rather than a lease arrangement, refer to IRS Revenue Ruling 55-540, 1955-2 C.B. 39, and FTB Legal Ruling 94-2, March 23, 1994.

24320 Property Not Qualified

References (Repealed Sections) 17265(d); 24356.3(c)

The business expense deduction is not allowed if the property:

- Was transferred between members of an affiliated group;
- Was acquired as a gift or inherited;
- Was traded for other property;
- Was received from a personal or business relation as defined by IRC § 267, as modified by CR&TC §17265(d)(2)(A);
- Was received from a personal or business relation as defined by CR&TC §24427 through 24429, as modified by CR&TC §24356.3(c)(2)(A);
- Was received from a personal or business relation as defined by IRC §707(b); or
- Is described in IRC §179(d).

24400 Deduction Amount

References (Repealed Sections) 17265(g); 24356.3(f)

EDAM 24410 Partnerships
EDAM 24411 Personal Income Tax Taxpayers-Married Filing Separate
EDAM 24420 Basis reduction / Depreciation
EDAM 24430 Interaction with the Manufacturer's Investment Credit
EDAM 24440 Recapture

The maximum *deduction* the taxpayer may claim in any income or taxable year is determined by the number of years that have elapsed since the Program Area was designated, as follows:

Income or Taxable Years	Maximum Aggregate Cost	Maximum Deduction
Income or taxable year of designation and 1st year thereafter	$100,000	$40,000
2nd and 3rd income or taxable year thereafter	$75,000	$30,000
Each income or taxable year thereafter	$50,000	$20,000

No deduction is allowed for property purchased after the expiration of the Program Area designation.

24410 Partnerships

References (Repealed Section) 17265(d)(6)

In the case of a partnership, the percentage limitation (40%) of the aggregate cost of all qualified property shall apply at the partnership level and at the partner level.

24411 Personal Income Tax Taxpayers-Married Filing Separate

References (Repealed Section) 17265(b)

In the case of a husband and wife filing separate returns for a taxable year, the applicable deduction is equal to one-half (50%) of the otherwise allowable deduction.

24420 Basis reduction / Depreciation

The basis (cost for depreciation purposes) of the property is reduced by the amount allowed as a deduction. Depreciation of the cost of the property, less the amount deducted, is claimed using any method of depreciation normally allowed, beginning with the income or taxable year following the year in which the property is placed in service.

Taxpayers electing to take the business expense deduction cannot claim the additional first year depreciation allowed under IRC §179 / CR&TC §24356 for the same property.

24430 Interaction with the Manufacturer's Investment Credit

References 17053.49(b)(1)(C); 23649(b)(1)(C)

Taxpayers claiming the business expense deduction and the Manufacturers' Investment Credit (MIC) for the same property must reduce MIC qualified costs by the amount of the business expense deduction before computing the MIC. Taxpayers that elect to take the business expense deduction are not allowed to capitalize the expensed amount.

24440 Recapture

References (Repealed Sections) 17265(h); 24356.3(g): See also Cal. Code Regs. (CCR) § 17267.2-1(a); 24356.7-1

The business expense deduction is subject to recapture (added back to income) if, before the *close of the second income or taxable year after* the property is placed in service, the property ceases to be qualified property (sold, disposed of, or no longer used exclusively within the Program Area trade or business).

To recapture the amount deducted, add to the current year income, the amount previously deducted for that property.

Example: Corporation A purchases property on June 1, 1995 that qualifies it to take the Program Area business expense deduction. Corporation A's income year ends December 31 of each year. Corporation A disposes of the property August 5, 1997. The previous deduction is added to income in the 1997 tax year because the property was disposed of before the close of the second income or taxable year after the property was placed in service (12/31/1997). Corporation A will increase its basis in the asset by the recaptured amount effective January 1, 1997.

NOTE: The State Board of Equalization in an unpublished (uncitable) decision held that the statute requires the closure of two taxable years after the end of the taxable year in which the property is placed in service and the election to claim the deduction on the original return is made. *Appeal of Accurate Metal Fabricators, Inc., 32552, Cal. St. Bd. Of Equal., July 3, 2000.*

24500 Making the Election

References (Repealed Sections) 17265(a); 17265(c); 24356.3(a); 24356.3(b)

EDAM 24510 Members of an Affiliated Group

The taxpayer must make an election to treat the cost of qualified property as a business expense, on the original return filed for the income or taxable year the property is first placed in service. The election must specify the items to which the election applies and the portion of the cost taken into account for purposes of determining the deduction amount.

The election is not revocable, unless the taxpayer has obtained the consent of the Franchise Tax Board.

The taxpayer makes the election by filing:

- Form FTB 3805Z - Enterprise Zone/Program Area Deduction and Credit Summary.

24510 Members of an Affiliated Group

References (Repealed Sections) 24356.3(c)(5); 24356.3(c)(6)

For purposes of electing the business expense deduction, all members of an affiliated group are treated as one taxpayer. The deduction is properly apportioned among the members of the affiliated group.

An affiliated group is defined in IRC §1504 as modified by the California Revenue & Taxation Code, to replace "*at least 80%*" with "*more than 50%*" each place it appears in IRC §1504(a).

24600 Creating a Net Operating Loss

Unlike IRC §179, there is *no* statutory prohibition on the amount of business expense deduction amount that may create a net operating loss.

24700 Alternative Minimum Tax

References 17062; 23457

The business expense deduction is *not* listed as a tax preference item.

24800 Checklist to Determine Eligibility for the Business Expense Deduction

Checklist Items	Yes	No
Is the business qualified? • Is a trade or business conducted within a Program Area? See the *Taxpayer Defined* section.		
Is the property qualified? • Qualified property is tangible personal property that is subject to the allowance for depreciation. See the Qualified Property section. • Is the property used exclusively within the boundaries of a Program Area?		
Is the correct deduction amount claimed? • The limitation differs based upon the taxable or income year since the area designation. See *Deduction Amount* section. • Verify purchase on invoices or receipts. • Verify the date the property is placed in service.		
Was a timely election made? • Election made on original return? • Form FTB 3805Z – Enterprise Zone/Program Area Deduction and Credit Summary, or a separate statement attached to the return?		
Was the property acquired through a valid transaction? • See the *Property Not Qualified* section.		
Was correct depreciation claimed? • Basis must be reduced by the amount of the business expense deduction before depreciation is computed. • IRC §179 expense or additional first year depreciation may not be claimed on qualified property for which the business expense deduction is claimed. • A depreciation deduction on qualified property is not allowed in the same year the business expense deduction is claimed.		
Is the deduction subject to recapture? • Was the property sold, disposed of or no longer used by the taxpayer in the Program Area, before the close of the second income or taxable year after the property was placed in service? • Check the current location of the qualified property. • Check the sale or disposal date of qualified property.		

24900 Record Keeping Requirements

To support the business expense deduction claimed, the taxpayer must keep all records that document the purchase of the qualified property. This includes items such as purchase receipts and proof of payment. In addition, taxpayers should keep all records that identify or describe:

- The property purchased (such as serial numbers, etc.); and
- The location where the property is used